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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

XII. SECURITY FOR PERFORMANCE

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[Editorial note: The present draft chapter is a revision of draft chapter XII, "Security for performance", published as document A/CN.9/332/Add.7. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.7 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.7 are underlined. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [1] This chapter focuses on guarantees (also referred to in practice as "bonds" or "indemnities") in a countertrade transaction supporting the countertrade commitment. Guarantees supporting the performance of individual supply contracts are not specifically addressed since they do not raise issues particular to countertrade. In a given countertrade transaction, guarantees may be used to support the obligation to purchase goods, the obligation to supply goods, or both these obligations. Sometimes a guarantee supports the countertrade commitment by way of securing payment under a liquidated damages or penalty clause covering the countertrade commitment. Guarantees may also be used to support liquidation of imbalances in the flow of trade (below, paragraphs 40 to 48).

2. [2] Requiring guarantees may have the general advantage of preventing parties who are unreliable or who do not have sufficient financial resources from participating in the countertrade transaction. Guarantor institutions generally make careful inquiries about a party whose obligations they are asked to guarantee, and will normally provide guarantees only when they have reasonable ground for believing that the party can successfully perform the obligation. This may be of particular advantage to importers or exporters who are otherwise unable to determine whether a proposed counter-party is reliable.

3. [3] Depending upon its terms, a guarantee may be independent of, or accessory to, the underlying obligation. Under an independent guarantee, the guarantor is obligated to pay when the party to whom the underlying obligation is owed (the "beneficiary") presents to the guarantor the demand for payment and any additional document required under the terms of the guarantee. A required document may be, for example, a beneficiary's statement that the party who procures the guarantee (the"principal") is in breach of the underlying obligation, a beneficiary's statement specifying the circumstances that constitute the breach, or a certificate or decision by a third person or entity stating that the breach of the underlying obligation has occurred. The third person or entity, designated in the guarantee or in accordance with the guarantee, may be, for instance, an expert, a supervisory body, an arbitral tribunal or a court. An independent guarantee assures the beneficiary that, upon presenting the demand and any required document, prompt payment will be made even if there remains disagreement between the principal and the beneficiary as to whether the underlying obligation has been breached. The guarantor, in determining whether to pay, is not called upon to investigate whether the underlying obligation has in fact been breached, but is limited to verifying whether the demand for payment and any supporting document conform to the requirements specified in the guarantee. (For further discussion on

possible payment conditions, see below, paragraph 18.) If the dispute arises whether the principal is entitled to the recovery of the amount paid on the ground that the underlying obligation had not been breached, that dispute would be determined in any subsequent proceedings between the principal and the beneficiary. Even though the guarantor's obligation to pay is independent from the underlying obligation, the payment claim by the beneficiary under the guarantee may, in exceptional circumstances, be excluded under the law applicable to the guarantee, in particular when the claim by the beneficiary is fraudulent.

4. [4] Under an accessory guarantee, the guarantor must pay only when the principal is in fact in breach of the guaranteed obligation. Such accessory guarantees are referred to in national laws by terms such as "suretyship", "cautionnement", "fianza", and "Bürgschaft". The guarantor must, before paying a claim, ascertain whether the underlying obligation was breached in order to establish whether the claim is justified, and the guarantor is normally entitled to invoke all the defences that the principal could invoke against the beneficiary.

5. [5] The discussion in this chapter is limited to independent guarantees, without thereby implying a preference for this type of guarantee. Generally, independent guarantees are used to support obligations set out in the countertrade agreement. While principals tend to prefer accessory guarantees, beneficiaries are normally reluctant to accept such guarantees because of the possible delays involved in obtaining payment. Moreover, guarantors, in particular banks, tend to prefer independent guarantees because they do not wish to investigate the performance of the underlying obligation. While the various legal regimes governing accessory guarantees are well established, independent guarantees, essentially a creation of banking and commercial practice, are not yet firmly established in all national laws and there is no uniformity as regards the extent to which independent guarantees are recognized.

6. [6] In some countries banks issue "stand-by letters of credit", which are the functional equivalent of independent guarantees. Accordingly, the discussion in the legal guide on guarantees for security for performance by the principal applies to stand-by letters of credit.

B. Guarantee provisions in countertrade agreement

7. [7] When the parties decide to use a guarantee to support the countertrade commitment, they should include in the countertrade agreement certain basic provisions concerning the issuance and terms of the guarantee. The parties may also wish to consider appending to the countertrade agreement a form of a guarantee to be followed by the issuer in establishing the guarantee. In formulating the terms of the future guarantee in the countertrade agreement, the parties should be sure that the agreed formulation would be accepted by the guarantor.

8. [8] Typically it is the party committed to purchase whose commitment is supported by a guarantee. This is because the primary objective of that party in agreeing to a countertrade commitment is to secure a sale of its own goods, rather than to obtain goods from the other party. When the party committed to purchase goods has a particular interest in obtaining the goods, the supplier's commitment to conclude a contract for the supply of the agreed goods may be supported by a guarantee. As noted in paragraph 1, in some cases

the countertrade agreement may require both the purchaser and the supplier to obtain guarantees to support their commitments. When the parties to the countertrade agreement foresee that a third person may assume the countertrade commitment, the parties may wish to consider whether the guarantee should be procured by the third party or by the party originally committed (see chapter VIII, "Participation of third parties").

9. [9] When the guarantee supports the principal's obligation under a liquidated damages or penalty clause, the question whether a payment under the guarantee would free the principal from liability for fulfilment of the countertrade commitment or from liability for any damages beyond the amount of the guarantee would be settled by the terms of the liquidated damages or penalty clause and the rules applicable to the clause (see chapter XI, "Liquidated damages and penalty clauses", sections B and C). When the guarantee does not support a liquidated damages or penalty clause and the parties intend, as is sometimes the case, that payment under the guarantee would have the effect of freeing the principal from the countertrade commitment or from liability for any damages exceeding the amount paid under the guarantee, they should state their intention in the countertrade agreement. Without a provision to this effect, it cannot be assumed that payment under the guarantee would free the principal from the countertrade commitment or from liability for damages. It should further be noted that the fact that the obligation is supported by a guarantee does not give the obligated party the option of choosing between fulfilling the underlying contractual obligation and having the guarantee amount paid.

1. Choice of guarantor

10. [10] The parties may wish to specify in the countertrade agreement a guarantor who would be acceptable to both parties. That would enable the beneficiary to be satisfied that the guarantee would be issued by a guarantor that had the necessary financial reserves and that was otherwise acceptable. The identification of the guarantor could be useful to both parties in that it would limit subsequent disagreements and enable the parties to know the cost of the guarantee at the outset.

11. [11] If the guarantor is not identified at the time of the conclusion of the countertrade agreement, the parties may provide, for example, that the guarantor must be a first class bank, be agreeable to the beneficiary or be an institution from the home country of one of the parties.

12. [12] A beneficiary may wish to have the guarantee issued by an institution in its home country because enforcement of a claim for payment against such an institution might be easier than against a foreign institution. However, requiring the use of a local guarantor might be disadvantageous to the extent that the principal would be prevented from using a guarantor with whom it has an established relationship and who might provide the same guarantee at a lower cost. Furthermore, the guarantor in the beneficiary's country may require that reimbursement of any payment under the guarantee be secured by a bank acting in behalf of the principal, which may involve additional cost (see below, paragraph 14).

13. [13] In some States, mandatory rules applicable to the beneficiary provide that a guarantee may be accepted only if it is issued by a financial institution in the country or a financial institution authorized to issue

guarantees involving payment in a foreign currency or if the selection of the guarantor is approved by the competent authority.

14. [new paragraph] When the guarantee is to be issued by a bank in the beneficiary's country, that bank will often issue the guarantee only if reimbursement is secured through the issuance of a "counter-guarantee". The counter-guarantee entitles the bank issuing the guarantee to claim prompt reimbursement from the counter-guarantor in accordance with the terms of the counter-guarantee. The counter-guarantee would often be issued by the principal's bank that has instructed the guarantor to issue the guarantee.

15. [new paragraph] A similar requirement that payment be guaranteed by a bank in the beneficiary's country may apply when the security takes the form of a stand-by letter of credit. Such a requirement may be met by confirmation by a local bank of the stand-by letter of credit issued by a foreign bank. The confirming bank would obtain reimbursement from the issuing bank. Also a security in the form of a guarantee is sometimes confirmed by a bank in the beneficiary's country. In the case of both a confirmed stand-by letter of credit and a confirmed guarantee, the beneficiary has an option between claiming payment from the confirming bank or from the issuing bank.

16. [14] There have been instances where an undertaking to pay a sum of money, termed a "guarantee", supporting the countertrade commitment or the payment of related liquidated damages or penalties has been made by the party whose countertrade commitment is to be guaranteed. The effect of such a "guarantee" is that the party-guarantor promises to pay the other party under the terms of the guarantee without raising any defence that could not have been raised by a third-party guarantor, and that it is up to the party-guarantor to sue for reimbursement of the funds paid if it is claimed that the underlying obligation had not been breached. Such a guarantee might be acceptable to the beneficiary if the guarantee is independent from the underlying transaction and is issued by a trading party whose commercial integrity and financial adequacy are regarded by the beneficiary as being beyond doubt. However, it is not clear that such a guarantee gives the beneficiary legal rights in addition to those arising from the obligation being guaranteed.

2. Conditions for obtaining payment under the guarantee

17. [15] The countertrade agreement should clearly set forth the conditions that have to be fulfilled in order for the guarantor to be obligated to pay, in particular, as to any documents that have to be submitted in support of a claim for payment. If there is a lack of clarity, there is a greater likelihood that disputes would arise due to uncertainty as to whether the documents presented by the beneficiary conform to the terms of the guarantee.

18. [16] The terms of an independent guarantee may provide that a demand for payment alone would suffice, with the possible additional requirement that the demand would have to be accompanied by the beneficiary's statement concerning the breach. A general declaration to that effect may be sufficient. Alternatively, the beneficiary may be required to state more details, such as the nature of the principal's breach, that the beneficiary is entitled to payment of the claimed amount and that the amount has not yet been paid. In addition to the demand for payment, the beneficiary may be required

to present a document issued by a third person relating to the default by the principal; such a document may be, for example, a certificate of an independent expert, an arbitral award or a first-instance court decision stating that the default has occurred. The guarantee may provide that the requirement of a third-person statement would not apply if the principal makes an admission of default in writing. In all these cases, the guarantor merely ascertains whether the documents conform on their face to the requirements of the guarantee and is not to enquire into the underlying transaction. In particular, the guarantor is not to investigate whether the statements contained in a document are founded.

19. [17] Sometimes the parties agree that the beneficiary must notify the principal of the intention to call the guarantee and that the claim cannot be made before the expiry of a specified period of time following the notice. The purpose of such a notice requirement is to provide an opportunity to the principal to cure a breach or to settle a disagreement. A corollary guarantee term would require the beneficiary to submit with the demand for payment documentary evidence that notice had been given to the principal.

20. [18] Where the guarantee supports the payment obligation under a liquidated damages or penalty clause, the parties may wish to stipulate that among the payment conditions would be a requirement that the beneficiary must provide a statement that payment under the liquidated damages or penalty clause was due.

21. [19] In addition to documentary conditions, a guarantee will usually specify requirements that do not pertain to the performance of the underlying obligation. Such requirements, which do not involve the presentation of a document, most frequently concern the time period within which a claim can be made, the amount of the guarantee, and the office of the guarantor where the claim is to be submitted.

22. [20] It is advisable that the countertrade agreement, in addition to setting out the agreement of the parties as to the guarantee, provide that the beneficiary is entitled to claim under the guarantee only if there is in fact a failure to fulfil the commitment. Such a provision might facilitate recovery by the principal of losses suffered in the event that a claim is paid without there having been a breach of the underlying obligation.

3. Amount of guarantee and reduction of amount

23. [21] The parties should agree on the amount of the guarantee, as well as the currency in which it is to be denominated and payable. The amount of the guarantee is expressed as a specified amount or as a percentage of the value of the outstanding commitment. If the guarantee is to support payment under a liquidated damages or penalty clause, the guarantee clause in the countertrade agreement may call for the guarantee to cover payment of the entire amount of the liquidated damages or penalty or of a portion thereof. The liquidated damages or penalty may itself be a certain percentage of the unfulfilled countertrade commitment. (Concerning the amount of the liquidated damages or a penalty, see chapter XI, section D.)

24. [22] In determining the amount of the guarantee, or of the liquidated damages or penalty covered by the guarantee, the parties would take into account factors such as the extent of the losses expected to be suffered in

the event of non-fulfilment and the risk of failure to fulfil, as well as the limits which guarantors would usually observe in respect of similar contracts. Another factor may be the ease with which payment of a claim under the guarantee could be obtained. In this respect, the beneficiary generally has a trade-off to make. The closer the terms of the guarantee approach that of a simple demand guarantee and the easier it will be to obtain payment, the less willing the principal might be to provide a guarantee covering a high percentage of the countertrade commitment. On the other hand, if the documentary conditions are more difficult to meet when the principal has not breached the commitment (e.g., when an arbitral or court decision must be presented), the principal might be willing to agree on a higher amount for the guarantee.

25. [23] The parties may wish to include in the terms of the guarantee a mechanism to reduce the amount of the guarantee as fulfilment of the countertrade commitment progresses. Reduction of the guarantee amount would have the advantage of reducing the exposure under the guarantee and possibly the cost of the guarantee. If the guarantee secures payment of liquidated damages or a penalty, the provisions on the reduction of the guarantee should be consistent with any reduction mechanism for the sum of the liquidated damages or penalty.

26. [24] It is advisable that the reduction mechanism operate on the basis of the presentation to the guarantor of specified documents evidencing fulfilment of the countertrade commitment, without the guarantor being obligated to verify the degree to which the countertrade commitment has been fulfilled. These documents may include shipping documents, copies of supply contracts, purchase orders, letters of release or other documents recording fulfilment. The parties may also find it useful to stipulate the issuer of the documents and the party responsible for forwarding them to the guarantor. Where the fulfilment period is divided into subperiods, the parties may wish to provide that the guarantee will be reduced by the amount allocated for each subperiod and not claimed within the agreed period of time.

4. Time of providing guarantee

(a) At entry into force of countertrade agreement or shortly thereafter

27. [25] The parties are advised to agree on the point of time when the guarantee is to be issued. It may be agreed, for example, that the guarantee should be issued to the beneficiary when the countertrade agreement enters into force or shortly thereafter (e.g., thirty days after entry into force of the countertrade agreement). The parties may obtain assurance that the guarantee would be procured at the agreed time by providing that the countertrade agreement would not enter into force without procurement of the guarantee or that the principal would be deemed to have breached the countertrade commitment if the guarantee was not procured within the agreed period of time.

28. [26] When a contract in one direction (export contract) is concluded together with the countertrade agreement, the parties could agree that the issuance of a guarantee supporting fulfilment of the countertrade commitment is a condition for the entry into force of the export contract. Such a provision would assure the importer of not being bound under the export contract before issuance of a guarantee to support the countertrade commitment.

(b) Later in fulfilment period

29. [27] The parties may agree that the guarantee would only have to be procured at a certain date later in the fulfilment period if by that time fulfilment of the commitment was not yet completed. The agreed date may be, for example, three months before the end of the fulfilment period or three months before the end of each yearly segment of a multi-year fulfilment schedule. This approach has the advantage that the amount of the guarantee could be calculated as a percentage of the then outstanding countertrade commitment. By making the amount of the guarantee dependent on the outstanding balance rather than on the entire countertrade commitment and by limiting the length of time during which a guarantee is in effect, the extent of exposure under the guarantee as well as the cost of the guarantee are likely to be reduced.

30. [28] Since such an approach exposes the beneficiary to the risk that the guarantee will not be procured, the parties may wish to agree on the beneficiary's rights in the event the guarantee is not procured as agreed. It may be agreed that the beneficiary would be permitted to regard the countertrade commitment as breached and to claim payment under a liquidated damages or penalty clause. Furthermore, it might be agreed that the beneficiary would be entitled to deduct the amount of the liquidated damages or penalty from any amounts becoming due under the export contract after the failure to procure the guarantee.

5. Duration of guarantee

(a) Expiry date

31. [29] It is advisable for the parties to agree on the clause that should be included in the guarantee concerning the length of time the guarantee is to remain in force. It should be noted that, in view of the independence of the guarantee from the underlying countertrade agreement, the clause in the countertrade agreement concerning the period of validity of the guarantee will not determine the duration of the guarantee as specified in the guarantee. Guarantees usually contain a fixed expiry date. Another possibility would be to provide for an open-ended guarantee that would terminate only when the countertrade commitment was fulfilled or the committed party was otherwise released from the commitment (see chapter IV, "Countertrade commitment", paragraphs 35 to 37). It should be noted that most guarantors would be willing to issue guarantees only if the expiry date is fixed. It should also be noted that the laws of some States contain mandatory rules governing the validity period of guarantees. *

32. [30] It is advisable that the expiry date of the guarantee fall after the end of the period for the fulfilment of the countertrade commitment. A period of time between expiry of the fulfilment period and expiry of the guarantee (e.g., thirty days) would allow the beneficiary to await the conclusion of supply contracts until the close of the fulfilment period without foregoing the possibility of claiming payment under the guarantee. Furthermore, the beneficiary, at its discretion, would be able to allow minor delays attributable to the principal in the fulfilment of the countertrade commitment without foregoing the possibility of claiming payment under the guarantee. At the same time, if kept relatively short, the interval would allow the liability of the guarantor to be resolved relatively soon after the

alleged non-fulfilment of the countertrade commitment has taken place. The parties may also wish to apply such an approach in relation to guarantees covering subperiods of a fulfilment period.

33. [new paragraph] In the absence of a provision in the guarantee defining the effect of the expiry date, it is widely understood that a demand for payment, accompanied by any required documents, must be made before or on the expiry date, and that, accordingly, the guarantor is not obligated to pay any demand made after that date. However, according to the interpretation of courts of some jurisdictions, absent a provision to the contrary, the demand for payment can validly be made after the expiry date, provided that the contingency for which the guarantee had been given has occurred before or on the expiry date. Under such an interpretation, a demand for payment may be made either within a reasonable period of time after the expiry date or, according to some courts, even during a period of limitation or prescription.

[31] *

(b) Return of guarantee instrument

34. [32] In some States a guarantee may remain in force even after the expiry date if the guarantee instrument is not returned by the beneficiary. The countertrade agreement should therefore obligate the beneficiary to return the guarantee promptly upon fulfilment of the guaranteed obligation. However, the obligation to return the guarantee should be drafted so as not to imply that if the guarantee is not returned it remains in force even after the expiry date.

(c) Extension

35. [33] For various reasons, the time period for fulfilment of the countertrade commitment may be extended and as a result continue beyond the expiry date of the guarantee (see chapter IV, "Countertrade commitment", paragraphs 13 to 16, concerning extension of the fulfilment period). The countertrade agreement might provide that, if the fulfilment period is extended, the principal would be obligated to arrange within a reasonable period of time a corresponding extension of the guarantee. Alternatively, the guarantee might provide for an automatic extension to cover any extension of the underlying fulfilment period agreed to by the parties. However, such a provision might not be acceptable to a guarantor who did not wish to be bound by a guarantee the duration of which would depend on an agreement to which the guarantor was not a party.

36. [34] With respect to the cost of extending the period of validity of the guarantee, the parties may wish to agree that the party responsible for the extension of the fulfilment period would be obligated to bear the costs of the extension of the guarantee period.

6. Modification or termination of countertrade agreement

37. [35] In national laws that recognize the agreement of the parties to establish an independent guarantee, an independent guarantee would remain in effect as stipulated regardless of changes in the underlying commitment. If the change in the underlying contract affects the possibility to obtain the documents required to support of the payment claim under the independent

guarantee, it should be ensured that the change in the underlying contract is reflected by a corresponding modification of the guarantee terms.

38. [36] Under some national laws that do not fully recognize an independent guarantee, an alteration of the underlying commitment may result in the release of the guarantor; under other such national laws, the guarantee may be deemed to cover only the commitment of the principal existing at the date of issuance of the guarantee. With a view to avoiding undesired consequences, the parties may provide that the guarantee would remain in force despite modifications of the countertrade agreement.

39. [37] The modification of the countertrade agreement may extend the liability of the principal beyond the amount of the guarantee. The parties may wish to provide in the countertrade agreement that in those cases the principal would be obligated to ensure that the amount of the guarantee would be modified accordingly.

C. Guarantee for imbalance in trade

40. [38] The parties may agree that goods will be shipped in exchange for goods and that the shipments in each direction will not be paid for in money. This type of transaction may be based on a barter contract (see chapter III, "Contracting approach", paragraphs 3 to 8) or on the setoff of countervailing claims for payment (see chapter IX, "Payment", section D). In such cases a supplier runs the risk that the value of its shipments may exceed the value of goods received from the other party and that this imbalance is not liquidated, either by supplies of goods or through payment in money. In order to address this risk, the parties may use guarantees to secure liquidation of an imbalance that may develop in the flow of trade. It may be agreed that the imbalance should be liquidated at the end of the period for the fulfilment of the countertrade commitment or at specified points of time during that period.

41. [39] The amount of the guarantee should be linked to the amount of the imbalance in the flow of trade, with an upper limit. This upper limit for the guarantee could be set at the level of imbalance permitted under the countertrade transaction. It may be agreed that the amount that could be claimed under the guarantee would cover less than the full extent of the imbalance (e.g., 80 percent). The purpose of such an approach would be to discourage the calling of the guarantee except as a last resort. A beneficiary who could not recover the full amount of the imbalance by calling the guarantee would have a greater incentive to achieve the agreed balance in the flow of trade through ordering goods from the other party.

42. [new paragraph] When a third person holds information concerning the flow of the deliveries between the parties (e.g., the bank administering the setoff account), it can be stipulated in the guarantee that a demand for payment must be accompanied by a statement by that third person certifying the amount of the outstanding imbalance. Furthermore, the guarantee can stipulate that the guarantor is authorized to pay a demand only up to the amount of the certified imbalance.

1. Guarantee for shipment in one direction

43. [41] Where a particular sequence of shipments in the two directions is stipulated, the countertrade agreement may provide that the party scheduled to receive goods first must provide a guarantee supporting the obligation to ship goods in return. This guarantee would cover the risk taken by the party that ships first that the return shipment fails to take place by the agreed date or is not of the agreed value or quantity. When the first shipment is to take place in stages, it may be agreed that with each partial shipment a separate guarantee is to be provided corresponding to the value of that shipment; alternatively, the parties and the guarantor may agree that the guaranteed amount will increase upon the presentation of documents evidencing additional shipments.

44. [41] With respect to the timing of the issuance of the guarantee, the countertrade agreement may provide that the guarantee is to be handed over to the beneficiary in exchange for the shipping documents relating to the first delivery. Such a procedure would safeguard against the possibility that the party scheduled to ship first would be given the guarantee but would then fail to ship. In order to ensure that the beneficiary of the guarantee (the party that has shipped first) would not be in a position to claim payment under the guarantee once the principal (the party shipping second) has fulfilled its obligation to ship goods, the countertrade parties may agree that the beneficiary of the guarantee would obtain documents of title to the second shipment only upon surrender of the guarantee instrument.

45. [42] Guarantees may be used in a similar fashion in multi-party countertrade transactions. When the parties link deliveries in such a fashion that the importer, in exchange for goods received from the exporter, ships goods to a third-party counter-importer, the third-party counter-importer pays the exporter (see chapter IX, "Payment", paragraph 68). The guarantee, provided by the importer, would support the obligation to counter-export after receiving the export goods. When the exporter is to be paid by the counter-importer upon shipment of the export goods, the counter-importer would be the beneficiary of the guarantee. Such a guarantee would cover the risk taken by the counter-importer in paying the exporter prior to receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon receipt of the counter-export goods, the exporter would be the beneficiary of the guarantee. Such a guarantee would cover the risk that the exporter, having shipped goods, failed to be paid by the counter-importer because the counter-export did not take place.

46. [43] A similar guarantee may be used when the exporter, instead of being paid by the importer, receives goods from a third-party counter-exporter, who in turn is paid by the importer (see chapter IX, paragraph 68). In this case, it may be agreed that the exporter would be given a guarantee covering the risk that, having shipped first, the exporter failed to be compensated by a shipment of goods from the counter-exporter.

47. [44] A guarantee may be employed in a similar fashion when both the counter-importer and the counter-exporter are separate parties from the exporter and the importer (see chapter IX, paragraph 69). It may be agreed that the importer must provide a guarantee to the exporter to support the importer's obligation to pay the price of the export goods. When the exporter is to receive payment from the counter-importer upon shipment of the export

goods, the beneficiary would be the counter-importer. This would protect the counter-importer against the risk of paying the exporter without receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon shipment of the counter-export goods, the beneficiary of the guarantee would be the exporter. This would protect the exporter against the risk of shipping goods without being paid.

2. Mutual guarantees

48. [45] When the parties agree to exchange goods for goods, they may do so without stipulating a particular sequence in which the shipments in the two directions should take place. This is particularly likely when multiple shipments in each direction are envisaged. In such situations, both parties encounter the risk of an imbalance in the flow of trade which needs to be redressed either through the shipment of goods or through the payment of a sum of money. To address this risk, it may be agreed that each party is to provide a guarantee to secure liquidation of an imbalance in favour of the other party.

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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

XIII. FAILURE TO COMPLETE COUNTERTRADE TRANSACTION

Contents

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A. General remarks

1. [1] This chapter discusses remedies for non-fulfilment of the countertrade commitment (sections B and C). The chapter also discusses circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (section D). A further issue discussed in the present chapter is the effect of a failure to fulfil the countertrade commitment or of the failure to perform a supply contract in one direction on the obligations of the parties to conclude or perform supply contracts in the other direction (section E). Not discussed are remedies for non-performance of a supply contract concluded pursuant to the countertrade agreement, since such remedies are of a type available under contract law generally and do not raise issues specific to countertrade.

2. [new paragraph] The discussion in this chapter is set in the context of "firm" countertrade commitments, i.e., commitments in which a party undertakes to actually conclude a supply contract in accordance with the terms stipulated in the countertrade commitment. As noted in chapter IV, paragraph 2, the Legal Guide does not deal with countertrade commitments containing a lower degree of commitment (e.g., "best efforts" or "serious intention" types of commitment), under which the undertaking is limited to an obligation to negotiate in good faith without promising that a contract will actually be entered into.

3. [2] Failure by a party to fulfil its obligations under the countertrade transaction could have serious repercussions for the other party. The repercussions may be, for example, that a prospective supplier will not earn convertible funds planned to be used for the purchase of other goods, that a prospective supplier will be hampered in carrying out its plan to introduce countertrade goods into new markets, or that a prospective purchaser will not receive goods to be resold in order to pay for goods shipped in the other direction.

4. [3] It is advisable that the countertrade agreement stipulate the remedies for a failure to fulfil the countertrade commitment. National laws generally do not contain rules specifically tailored to countertrade, and general rules applicable to contractual obligations may not provide satisfactory answers when problems occur in fulfilling the countertrade commitment. The remedies that the parties might wish to address in the countertrade agreement include release from the countertrade commitment and liquidated damages or a penalty (see below, paragraphs 5 to 13). It is also advisable that the countertrade agreement define the circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (see below, paragraphs 14 to 37).

5. [4] The remedies for non-fulfilment of the countertrade commitment that the parties have decided to include in a countertrade agreement may not be appropriate in every circumstance. Therefore, while a party has the right to insist upon the remedies set forth in the countertrade agreement, the parties may find it desirable to negotiate in the light of the available remedies before resorting to the procedures available to enforce them (see discussion on negotiation in chapter XV, "Settlement of disputes", paragraphs 8 to 11).

B. Remedies

1. Release from part or all of countertrade commitment

6. [5] There are various circumstances in which a party may be released from its obligations under the countertrade commitment. Such a release can result from a payment of liquidated damages or a penalty stipulated in the countertrade agreement for non-fulfilment of the countertrade commitment (see chapter XI, "Liquidated damages and penalty clauses", paragraph [12]) or when the countertrade commitment is terminated after the payment of liquidated damages or a penalty covering delay have reached the agreed cumulative limit (see chapter XI, paragraph [19]). A release of a party may also result when an action or omission by the other party causes the failure to fulfil the commitment (see paragraph 6, below). A further ground for a release may be the occurrence of circumstances that the applicable law or the countertrade agreement defines as exempting impediments (see paragraphs 14 to 37, below). Yet another situation in which a party may be released is when the supply contract in the other direction is terminated (see paragraph 48, below). A party may be released from all of the unfulfilled countertrade commitment or from only a portion thereof. If the circumstances that give rise to the release affect only a portion of the unfulfilled countertrade commitment, the remaining portion of the countertrade commitment remains in effect.

7. [6] A party may be entitled, in accordance with legal rules generally applicable to the breach of a contractual obligation, to be released from the countertrade commitment if the other party fails to take the action necessary to fulfil the commitment. Nevertheless, the parties may wish to address in the countertrade agreement the question of the release from the countertrade commitment in order to establish a clear understanding as to the instances in which a party is to be released and as to the extent of release. This could take the form of a clause to the effect that, if the party committed to supply breaches its obligation to make available a portion or all of the goods in accordance with the terms of the countertrade agreement, the party committed to purchase is released from an equivalent portion or all of the countertrade commitment. Similarly, the parties may wish to agree that, if the party committed to purchase breaches its obligation to purchase a portion or all of the goods made available in accordance with the terms of the countertrade agreement, the party committed to supply is released from an equivalent portion or all of the countertrade commitment. When the parties so agree, they may wish to establish a notice requirement. Such a requirement might specify that the aggrieved party has to deliver a notice to the party in breach specifying the breach and informing the party in breach that the aggrieved party would be released from its obligations under the countertrade commitment to the extent that the breach was not remedied within a period of time specified in the notice or in the countertrade agreement. The period of time should be of a sufficient length to allow the remedying of the breach.

The parties may wish to provide that the period of time commences to run from the date of the delivery of the notice. The parties may wish to consider whether it would be desirable to provide that, for the release to take effect, a second written notice would have to be delivered by the party claiming release.

8. [7] Sometimes the countertrade agreement sets subperiods within the fulfilment period in which specified portions of the countertrade commitment must be fulfilled (for a discussion of such subperiods, see chapter IV, "Countertrade commitment", paragraphs 17 to 20). Such schemes often provide that a committed party that fails to fulfil the commitment allocated to a given subperiod may carry over a portion of the unfulfilled commitment to the following subperiod and that the party in breach must pay liquidated damages or a penalty on the unfulfilled portion that is not carried over. In such cases it may be provided that the party in breach is to be given an additional period of time, after the expiry of the subperiod, to remedy the breach (see the preceding paragraph).

9. [8] It should be noted that, as to the termination of contracts as a result of a breach, some national laws contain special requirements. For example, it may be required that additional time be granted to remedy the breach, that notice of intent to terminate be given, or that judicial consent be given. To the extent a countertrade agreement is regarded as governed by the rules applicable to contracts, those requirements would be applicable.

10. [9] The countertrade agreement may provide that, if a release results from circumstances not attributable to either party (e.g., an exempting impediment), each party is to bear its own expenses and losses.

2. Monetary compensation

[10] *
[11] *

11. [12] It might be possible for the party who suffered loss as a result of a failure to fulfil a countertrade commitment to claim, on the basis of legal rules generally applicable to a breach of a contractual obligation, damages from the party who failed to fulfil the commitment. The problem of liability for failure to fulfil a countertrade commitment raises the question of pre-contractual liability. The answer to this question is often not clear in national laws, the approaches to the question differ under the laws of various States, and in some States the law of pre-contractual liability is undeveloped. A further source of uncertainty is the basis on which the extent of the damages would be calculated. If the important terms of the future supply contract (in particular type, quality and price of goods) are not sufficiently defined in the countertrade agreement, there would be an insufficient basis on which to calculate damages resulting from a failure to conclude that contract.

12. [new paragraph] If the parties agree that a party should obtain monetary compensation as a result of non-fulfilment of the countertrade commitment, they may, in order to avoid the uncertainties mentioned in the previous paragraph, include in the countertrade agreement a clause on liquidated damages or a penalty (see chapter XI, "Liquidated damages and penalty clauses").

[12] *

C. Exempting impediments

13. [14] During the course of the period for fulfilment of the countertrade commitment, events may occur that impede a committed party to conclude an envisaged supply contract. An impediment may be of a legal nature, such as a change of regulations in the purchaser's or the supplier's country prohibiting the import or export of certain types of goods. An impediment may also be of a physical nature, such as a natural disaster preventing the production, transport or taking delivery of countertrade goods. Impediments may prevent fulfilment of the countertrade commitment permanently or only temporarily. The party who fails to fulfil its countertrade commitment due to an impediment may, subject to the applicable law and to the provisions of the countertrade agreement, be granted additional time to fulfil the commitment or be released altogether from the countertrade commitment, and be exonerated from liability to pay damages. Impediments that give rise to such an exemption are referred to in the Legal Guide as "exempting impediments".

14. [15] Many national laws contain rules concerning exempting impediments. If an event impeding fulfilment of the countertrade commitment has the characteristics set forth in the applicable law (such as that the event was unforeseeable and unavoidable) the parties would be released from the commitment as a result of those rules. However, those rules may lead to results that are incompatible with the circumstances and needs of international countertrade transactions or do not allocate the risk of occurrence of exempting impediments as desired by the parties. Therefore, the parties may wish to include in their countertrade agreement an exemption clause defining exempting impediments and specifying the legal consequences of those impediments. It is advisable for the parties to select terminology that is, in the light of the applicable law, consistent with their intentions (see chapter V, "General remarks on drafting", paragraph 6).

15. [16] In the negotiation of the clause in the countertrade agreement on exempting impediments, it is in the interest of each party to have included in the clause the types of exempting impediments that could affect the ability of that party to take the actions required to fulfil the countertrade commitment. For example, the party committed to purchase would be interested in covering impediments such as import restrictions and physical impediments to the taking of delivery or the use of the goods. The party committed to supply goods would be interested in covering impediments such as restrictions on goods permitted to be exported in countertrade transactions and other export restrictions and certain impediments affecting the ability to produce the goods. Under the generally accepted principle of freedom of contract, the parties have latitude to agree on which of the parties is to bear the risk that a particular type of event that impedes performance may occur. Accordingly, they could exclude from the list of exempting impediments events that would be treated as exempting impediments by the applicable law and to include other events that would not be so treated by the applicable law. It should be noted, however, that some national laws establish mandatory limits to the freedom of a party to waive its right to rely on exempting impediments recognized under the law.

16. [17] The treatment in various national laws of the subject of exemption differs with respect to the conceptual underpinnings of the subject and the terminology used. In relation to exemptions in the context of sales contracts, those differences have been bridged by the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), article 79. 1/ The approach adopted in that Convention has been designed to take into account the particular circumstances and needs of international trade. The parties may find that approach to be a useful guide in formulating an exemption clause in a countertrade agreement. The discussion in this chapter of the legal consequences of exempting impediments and the definition of exempting impediments is based upon the approach taken in the Convention.

1. Legal consequences of exempting impediments

17. [18] The parties may wish to provide that, when fulfilment of the countertrade commitment is prevented by exempting impediments not exceeding a specified duration (e.g., 6 months), the fulfilment period would be extended for a period of time corresponding to the duration of the impediment. The purpose of such a provision would be to ensure that exempting impediments of a limited duration would not release the parties from the countertrade commitment. The parties may wish to stipulate in the countertrade agreement that, if an exempting impediment invoked by a party lasts longer than a specified duration, the other party may claim release from the countertrade commitment, or it may be agreed that either party may do so. The parties may wish to include in such a stipulation the obligation to engage in negotiations aimed at modifying the countertrade agreement in order to preserve the countertrade commitment.

18. [19] As discussed in chapter XI, "Liquidated damages and penalty clauses", paragraph [7], in order to eliminate any uncertainty, the parties may wish to provide expressly that a party failing to fulfil the countertrade commitment due to an exempting impediment is exempt from the payment of liquidated damages or penalties, or of any damages that would otherwise be due under the applicable law.

2. Defining exempting impediments

19. [20] While many national laws contain definitions of exempting impediments, the parties may wish, for reasons noted above in paragraph [15], to include in the countertrade agreement a definition of exempting impediments. The parties may wish to adopt one of the following approaches: (a) providing only a general definition of exempting impediments; (b) combining a general definition with a list of exempting impediments; (c) providing only an exhaustive list of exempting impediments.

(a) General definition

20. [21] A general definition of exempting impediments would enable the parties to ensure that all events having the characteristics set forth in the definition would be considered as exempting impediments. The purpose of a general definition is also to exclude events that do not meet those characteristics. This approach would avoid the need to compile a list of exempting impediments, and would avoid the risk of omitting from the list events that the parties would have considered as exempting impediments. On

the other hand, it could be difficult in some cases to determine whether or not a particular event was covered by the general definition.

21. [22] The parties may wish to clarify in the definition that fulfilment of the countertrade commitment must be prevented by a physical or legal impediment (see above, paragraphs 14 and 15), and not, for instance, only made inconvenient or more expensive. It should be noted, however, that a change in circumstances may occur that makes fulfilment of the countertrade commitment, while still physically possible, excessively costly, beyond what a party could be expected to have foreseen and to have to bear. Such an extreme change in circumstances may be regarded under the applicable law as an exempting impediment. In addition, the parties may wish to provide that the impediment must be beyond the control of the party failing to fulfil a countertrade commitment and that that party could not reasonably be expected to have taken the impediment into account at the time the countertrade agreement was entered into or to have avoided or overcome the impediment or its consequences (this wording is modelled on article 79 of the United Nations Sales Convention).

22. [23] Contractual clauses on exempting impediments sometimes merely list a number of exempting impediments and indicate that other similar events would also be considered as exempting impediments. In such a clause, the listed events serve as an indication whether an event not included in the list should be regarded as an exempting impediment. Nevertheless, inclusion of a general definition in the clause is likely to reduce uncertainty as to whether an event not included in the list should be regarded as an exempting impediment.

(b) General definition with list of exempting impediments

23. [24] A general definition of exempting impediments might be followed by either an illustrative or exhaustive list of events that are to be regarded as exempting impediments. This approach would combine the flexibility afforded by a general definition with the certainty arising from the specification of exempting impediments.

(i) General definition with illustrative list

24. [25] Examples of exempting impediments to be included in an illustrative list may be chosen so as to clarify the scope of the general definition. Such an approach could give guidance as to the intended scope of the general definition and ensure that the events set forth in the list would be treated as exempting impediments if they meet the criteria set forth in the general definition.

(ii) General definition with exhaustive list

25. [26] A general definition of exempting impediments might be followed by an exhaustive list of events that are to be regarded as exempting impediments if in a given case they meet the criteria contained in the definition. An exhaustive list may be inadvisable unless the parties are certain that they can foresee and list all events which they would wish to be regarded as exempting impediments.

(iii) General definition with list of exempting impediments whether or not they come within definition

26. [27] A general definition of exempting impediments might be followed by a list of events that are to be regarded as exempting impediments whether or not they come within the general definition. This approach may be useful where parties choose a narrow general definition of exempting impediments, but wish certain events that do not fall within the scope of that definition to be regarded as exempting impediments. Since those events would constitute exempting impediments independently of the general definition, the remarks in paragraph 28, below, concerning safeguards that may be adopted when providing a list of exempting impediments without a general definition, are also applicable here.

(c) Exhaustive list of exempting impediments without general definition

27. [28] It is possible for an exemption clause simply to provide an exhaustive list of events that are to be considered exempting impediments, without a general definition. This approach has the disadvantage of not providing general criteria in a definition that the listed events must meet in order to be regarded as exempting impediments. Since such general criteria are not provided, it is advisable for the parties to describe the exempting impediments on the list as precisely as possible. The advantage of such precision is certainty as to the allocation of risk between the parties.

(d) Possible exempting impediments

28. [29] If the parties set forth in the exemption clause a list of events that are to be considered exempting impediments, with or without a general definition, they may wish to consider whether it is desirable to include events such as fire, explosion, and trade embargo. Furthermore, the parties may wish to narrow the scope of the events listed below.

29. [30] Natural disasters. Natural disasters such as storms, cyclones, floods or sandstorms may be normal conditions at a particular time of the year at the relevant location. In such cases, the countertrade agreement contract might preclude a party from invoking them as exempting impediments if they were foreseeable and if effective counter-measures could have been taken (see paragraph 23, above).

30. [31] War (whether declared or not), other military activity or civil unrest. It may be difficult to determine when a war, other military activity or civil unrest can be considered as preventing performance of an obligation. For instance, hostilities may be taking place in the country of a party, but, if commercial activities by that party continue, the hostilities may not actually prevent a party from fulfilling the countertrade commitment. If the countertrade agreement does not contain a general definition of exempting impediments, it may be desirable to specify clearly when a war, other military activity or civil unrest is considered to prevent fulfilment of a countertrade commitment.

31. [32] Strikes, boycotts, go-slows and occupation of factories or premises by workers. The parties may wish to consider whether and the extent to which these events are to be considered as exempting impediments. On the one hand,

such events could in a real sense prevent a party from fulfilling its commitment. On the other hand, the parties might consider that it would not be advisable for a party to be exempted from the consequences of a failure to fulfil a commitment when the failure resulted from the conduct of its own employees. In addition, it may be difficult to determine whether or not strikes by employees and other labour disputes are avoidable by a party, and what measures the party might reasonably be expected to take to avoid or to end the strike or dispute (e.g., meeting the strikers' demands). *

32. [33] Shortages of raw materials needed in production. The parties may wish to consider whether this is to be considered as an exempting impediment. They might, for example, consider that it is the obligation of a party to procure raw materials in time and, therefore, preclude a claim for an exemption if the raw materials had not been procured. In some cases, the party may fail to have the materials available on time due to a delay by its supplier. For those cases, however, it would be advisable for the party to ensure that the contract with its supplier of the materials provides for damages for failure to supply the materials.

(e) Exclusion of impediments

33. [34] Whichever approach to defining exempting impediments is adopted, the parties may wish further to clarify the scope of an exemption clause by expressly excluding some events. For example, the parties may wish to exclude from exempting impediments events that occur after a breach of the countertrade commitment by a party and that, but for the breach, would not have prevented fulfilment of the commitment by that party.

34. [35] The parties may wish to consider whether certain acts of a State or of State organs are to be regarded as exempting impediments. A party may be required to secure a licence or other official approval for the conclusion of a supply contract. The countertrade agreement might provide that, if the licence or approval is refused by a State organ or if it is granted but later withdrawn, the party that was required to obtain the licence or approval cannot rely on the refusal or withdrawal as an exempting impediment. The parties might consider that it is equitable for the consequences of the absence of the licence or approval to be borne by the party that had the duty to obtain it, since that party undertook the countertrade commitment knowing of the necessity to obtain the licence or approval and the possibility of its being refused. Moreover, it might be difficult for the other party to determine whether the measures taken to obtain the licence or approval were reasonable (see paragraph 23, above). The parties may wish to stipulate the circumstances in which the party who is required to obtain the licence could be exonerated by proving that the licence was refused or withdrawn for a reason not attributable to that party (for example, when after the conclusion of the countertrade agreement the Government imposed a licence requirement or changed its policy regarding granting or withdrawing licences).

3. Notification of impediments

35. [36] It is desirable for the countertrade agreement to clarify that a party invoking an exempting impediment must give written notice of the impediment to the other party without undue delay after the party invoking the impediment learned of the occurrence of the impediment. This notification could facilitate the taking of measures by

the other party to mitigate any loss. Such an obligation of notification and mitigation of losses exists under the general principles of contract law of many national laws. It may be required that the notice specify details of the impediment, together with evidence that the fulfilment of a countertrade commitment by the party is prevented or is likely to be prevented, and, if possible, the anticipated duration of the impediment. The party invoking the exempting impediment might also be required to continue to keep the other party informed of all circumstances that may be relevant for an ongoing appraisal of the impediment and its effects, and to notify the other party of the cessation of the impediment. It may be provided that a party who fails to notify the other party in time of the exempting impediment loses the right to invoke the exempting impediment. Alternatively, it may be provided that a party who fails to give the required notification in time remains entitled to invoke the clause, but is liable to compensate the other party for losses resulting from the failure. The countertrade agreement might also provide that an exempting impediment, or certain types of exempting impediments, must be verified, for example, by a public authority, notary public, a consulate or chamber of commerce in the country where the impediment occurred.

36. [37] Further, the parties may wish to provide that, upon notification of an exempting impediment, they are to consider jointly what measures to take in order to prevent or limit the effects of the impediment, and to prevent or mitigate any loss that may be caused by it. These measures might include re-negotiation of the countertrade agreement (see paragraph 18, above).

D. Effect on countertrade transaction of failure to conclude or perform supply contract

37. [38] A basic feature of a countertrade transaction, as noted in chapter II, paragraph 1, is the link between the supplies of goods in the two directions in that the conclusion of the contract for the supply of goods in one direction is conditioned upon the conclusion of the contract for the supply of goods in the other direction. In view of this link, a question may arise whether a failure to conclude a supply contract or a failure to perform an existing supply contract in one direction should have an effect on the obligation to conclude a supply contract or to perform an existing supply contract in the other direction. For example, if in a counter-purchase transaction the export contract is terminated, the question may arise whether the exporter is entitled to be released from its obligations to purchase goods pursuant to the countertrade commitment. Similarly, if in a counter-purchase transaction the exporter fails to take the action necessary to fulfil the countertrade commitment, the question may arise whether the counter-exporter is entitled to suspend payment under the export contract or to terminate the export contract.

38. [new paragraph] Such questions of interdependence may arise also in multi-party countertrade transactions. For example, in a tripartite transaction involving the exporter, the importer who is also the counter-exporter, and a third-party purchaser, the question may arise whether the failure by the third party to purchase the goods entitles the importer to suspend payment for goods purchased from the exporter. In another example, in a four-party countertrade transaction, the question may arise whether the failure to conclude or perform a supply contract between one pair of parties entitles a party to the contract in the other direction to suspend performance

of the contract or to terminate the contract. (Multi-party countertrade is described in chapter VIII, section D; for a discussion of linked payment mechanisms in multi-party countertrade, see chapter IX, section F.) The discussion in this section applies to countertrade transactions between two parties as well as to transactions involving more than two parties.

39. [new paragraph] While it is advisable, as discussed below, to include in the countertrade agreement provisions dealing with the interdependence of obligations, it is also advisable, when a problem arises in the completion of the transaction, for the parties to endeavour to find a negotiated solution. Negotiating a modification of the countertrade transaction is often preferable to a suspension or termination of the countertrade commitment or a supply contract.

40. [39] Many national laws contain general rules that provide an answer regarding interdependence of obligations incorporated in one contract. The general principle is that non-performance by one party of its contractual obligations under a contract authorizes the other party not to perform its obligations under that contract, and that in some circumstances the other party is authorized to terminate the contract. Usually non-performance of one's own contract obligations or termination of the contract is not authorized when the failure of the other party is not sufficiently serious. National laws normally do not provide a specific answer to the question of interdependence of obligations involved in various types of countertrade transactions and also do not clarify to what extent the above-mentioned general principles of contract law can be applied in a countertrade transaction.

41. [40] It is often suggested that the particular contract structure of the countertrade transaction is an important element in determining the interdependence of obligations in countertrade transactions. If the contractual terms concerning the countertrade commitment or supply contracts in the two directions are embodied in one contract, it is generally considered that the mutual obligations are likely to be considered as interdependent (see chapter III," Contracting approach", paragraphs 10, 17, 18). If, however, separate contracts are used, it has been suggested that under many national laws the two sets of obligations would likely be regarded as independent, except to the extent specific contract provisions establish interdependence (the separate-contracts approach is discussed in chapter III paragraphs 11 to 23). * On the other hand, it has been suggested that despite the use of separate contracts, the obligations in a countertrade transaction could be regarded as interdependent on the ground that those obligations embodied in separate contracts are commercially interrelated and thus form part of a single transaction.

42. [41] Because there is a dearth of judicial and arbitral decisions on the question of interdependence of obligations in countertrade transactions, generalizations cannot be made. The extent of interdependence will depend on the circumstances and contractual provisions of each case. In order to avoid disagreements as to whether a party is entitled to withhold fulfilment of its obligation as regards the supply of goods in one direction on the ground that the other party has failed to fulfil its obligation as regards the supply of goods in the other direction, the parties might wish to include in the countertrade agreement specific provisions indicating the extent of interdependence of obligations. Provisions determining the extent of

interdependence of obligations may be included to address in particular the following problems in the fulfilment of the countertrade transaction: (1) failure to conclude a supply contract as stipulated in the countertrade agreement, (2) termination of a supply contract, (3) failure to meet a payment obligation under a supply contract, and (4) failure to deliver goods under a supply contract.

1. Failure to conclude supply contract

43. [42] In transactions in which the parties first conclude the supply contract in one direction (export contract) and leave the conclusion of the supply contract in the other direction (counter-export contract) to a later time (see chapter III, "Contracting approach", paragraphs 13 to 19), the parties may wish to consider whether the failure of the exporter (counter-importer) to take an action necessary to fulfil the countertrade commitment should entitle the importer to suspend payment for the imported goods, or even to terminate the export contract. Such interdependence may be viewed favourably by an importer whose ability to meet payment obligations under the export contract depends on the proceeds of the counter-export contract to be concluded pursuant to the countertrade agreement.

44. [43] In considering whether to establish such interdependence between the countertrade commitment and the export contract, the parties may wish to take into account the possible amount of the counter-exporter's loss arising from the failure to fulfil the countertrade commitment and the possible amount of the exporter's loss arising from the suspension of payment under the export contract or from the termination of the export contract. It may not be desirable to allow a problem in the fulfilment of the countertrade commitment to disrupt the performance of the export contract. The parties may make such an assessment when the price to be paid under the export contract or the possible loss from the termination of the export contract is considerably higher than the possible loss from the failure by the counter-importer to fulfil the countertrade commitment. Furthermore, interdependence may not be desirable because of the possibility that the parties would disagree as to responsibility for the failure to conclude a supply contract. The possibility of suspension of payment under the export contract until the resolution of such a disagreement might introduce an unacceptable degree of uncertainty in the transaction. Moreover, the risk of non-payment under the export contract because of a problem in the fulfilment of the countertrade commitment may make it difficult for the exporter to find a financial institution to finance the export or to insure a non-payment risk. A reason for the financial institution's reluctance may be the fact that a possible difficulty the exporter may face in fulfilling the countertrade commitment is a circumstance extraneous to the export contract and difficult for the financial institution to assess. For reasons discussed in paragraphs 39 to 41, above, the parties may wish to express in the countertrade agreement such independence of the export contract from the fulfilment of the countertrade commitment.

45. [44] However, in order to protect the interests of the counter-exporter, it may be appropriate to provide in the countertrade agreement for compensation of the loss expected to be suffered as a result of a failure to conclude the counter-export contract. The obligation to provide such compensation may be established by a liquidated damages or penalty clause in the countertrade agreement (see paragraphs 10 to 13, above, as well as chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance").

Furthermore, the countertrade agreement may grant the counter-exporter the right to deduct from payments due under the export contract the amount of liquidated damages or a penalty due for the failure to fulfil the countertrade commitment (see chapter IX, "Payment", paragraphs 12 and 62, and chapter XI, "Liquidated damages and penalty clauses", paragraph 22).

46. [45] In transactions in which a countertrade agreement is concluded before the conclusion of supply contracts in either direction (see chapter III, "Contracting approach", paragraphs 20 and 21), the parties may not find it useful to entitle a party to suspend performance of, or to terminate, a concluded supply contract in one direction in response to a failure by the other party to take an action necessary to conclude a supply contract in the other direction. In such transactions, the countertrade agreement often provides for the conclusion of a series of supply contracts in both of the two directions. Making the performance of contracts that have already been concluded in one direction dependent on the conclusion of contracts in the other direction may disrupt rather than stimulate orderly implementation of such a countertrade transaction. Accordingly, for reasons discussed above in paragraphs 39 to 41, the parties may wish to indicate expressly in the countertrade agreement that the obligations under the supply contracts in one direction are independent from the fulfilment of the countertrade commitment in the other direction.

47. [46] In some cases the countertrade agreement may provide that a failure by a party to conclude supply contracts in one direction entitles the other party to suspend conclusion of contracts, or to suspend shipment of goods, in the other direction. Such an approach may be used in particular when it is agreed that during the course of the countertrade transaction the value of the goods supplied in one direction should not exceed the value of the goods supplied in the other direction by more than an agreed amount or percentage. This approach may be agreed upon when the parties stipulate that their mutual payment claims arising from the supply contracts in the two directions are to be set off and that the imbalance in the value of goods shipped in the two directions should not exceed an agreed limit (see chapter IX, "Payment", paragraphs 38 to 57, in particular paragraph 53). In order to monitor the level of trade between the parties and to specify the situations in which a party is entitled to suspend conclusion of contracts or supplies of goods, the parties might agree that their mutual supplies of goods are to be recorded in an "evidence account" (see chapter IV, "Countertrade commitment", paragraphs 68 to 74).

48. [47] When the countertrade agreement provides that the countertrade commitment in one direction should not affect obligations under existing supply contracts in the other direction, the countertrade agreement may nevertheless establish sanctions for the failure to fulfil the countertrade commitment. For example, in transactions in which countervailing claims for payment for the supply of goods in the two directions are to be set off, the countertrade agreement may provide that a party that receives more goods than it ships is to liquidate the imbalance either through cash payments or through the shipment of additional goods (see chapter IX, "Payment", paragraphs 53 to 56). When the goods supplied in the two directions are to be paid for independently, the countertrade agreement may contain a liquidated damages or penalty clause or provide for the issuance of a bank guarantee or stand-by letter of credit covering non-fulfilment of the countertrade commitment (see chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance").

2. Termination of supply contract

49. [48] A supply contract may be terminated, for example, as a result of a breach of the contract by one party or as a result of an exempting impediment. For reasons discussed in paragraphs 39 to 41, above, the parties may wish to clarify in the countertrade agreement whether such a termination of a supply contract in one direction is to affect the obligations of the parties to conclude a future supply contract in the other direction or to perform an existing supply contract in the other direction. Various solutions can be considered:

(i) not to allow the termination of a supply contract in one direction to affect the commitment to conclude a supply contract in the other direction, or any obligations under an existing supply contract in the other direction;

(ii) to provide that termination of a supply contract in one direction is to release the parties from the countertrade commitment stipulating the conclusion of a supply contract in the other direction, but that, if a supply contract in the other direction has already been concluded, that supply contract is not to be affected;

(iii) to provide that termination of the supply contract in one direction is to result in the release from the countertrade commitment to conclude a supply contract in the other direction as well as in the termination of any existing supply contract in the other direction, unless specified actions for performance of the existing supply contract have already been taken (e.g., goods have been prepared for shipment or have been shipped).

50. [49] The solution under (i) may be appropriate in transactions in which the countertrade agreement provides for the conclusion of a series of supply contracts in both directions. In counter-purchase and buy-back transactions, it may also be appropriate to provide that the termination of a given counter-export contract should not affect the export contract. In these cases it may be possible for the parties to conclude a substitute supply contract for a terminated supply contract (see paragraph 54, below). Because of this possibility, as well as the possibility of exercising remedies available under the terminated supply contract, the parties may not wish that the termination of a given supply contract in one direction should affect the conclusion or performance of contracts in the other direction. Furthermore, a possibility that the termination of the counter-export contract may affect the export contract may make it impossible for the exporter to obtain insurance cover for non-payment risk under the export contract. Inability to insure that risk may make it difficult or impossible for the exporter to obtain financing for the export contract (see chapter III, section C).

51. [50] As to the possible effects of the termination of the export contract in a counter-purchase, buy-back or indirect offset transaction, the solution under (i) may be preferred by the importer (counter-exporter). An important objective of the importer for engaging in countertrade is often to find an outlet for its goods, and the need to find such an outlet would usually not be diminished by termination of the export contract. This solution may also be favoured by a third-party purchaser engaged by the exporter to fulfil the exporter's countertrade commitment; the third-party purchaser may be

interested in the countertrade commitment remaining effective in order to be able to earn the fee agreed upon with the exporter or in order to recoup expenses incurred in anticipation of the purchase and resale of the countertrade goods (see chapter VIII, "Participation of third parties", paragraph 35). The exporter (counter-importer), on the other hand, is likely to favour solution (ii), in particular if the exporter does not expect a profit through the purchase and resale of the countertrade goods. In these types of transactions the exporter usually assumes a countertrade commitment in order to be able to export its own goods and would therefore not wish to remain subject to the countertrade commitment upon termination of the export contract, but at the same time would not wish to terminate existing counter-export contracts. In indirect offset transactions there is an additional reason for adopting the solution under (ii), namely, that the exporter (counter-importer) concludes counter-import contracts with third-party suppliers and it would be undesirable to terminate those contracts due to circumstances that do not concern those third parties.

52. [51] The question may arise whether, despite the release from the countertrade commitment, pursuant to the solution in (ii), of the party originally committed to purchase, a third-party purchaser engaged by the exporter (counter-importer) would continue to be entitled to receive a fee from the exporter (counter-importer) for purchases made from the counter-exporter after the release. As discussed in chapter VIII, "Participation of third parties", paragraph 35, it is advisable that the parties provide an express answer to this question in the countertrade agreement.

53. [52] The solution under (iii) might be adopted when the parties consider that the countertrade transaction cannot proceed if a supply contract in one direction is terminated. This might be the case, for example, when the parties agree to link their payment obligations so that the proceeds of the supply contract in one direction would be used to pay for the supply contract in the other direction (chapter IX, "Payment"), or when, as in a direct offset transaction, the goods supplied by one party are to be incorporated in the goods to be supplied in the other direction. The solution under (iii) would also be indicated in buy-back transactions in which the possibility of fulfilling the countertrade commitment is contingent upon the performance of the export contract.

54. [53] When solution (ii) or (iii) is adopted, the parties may wish to clarify in the countertrade agreement that a party would be released from its obligations under the countertrade commitment or an existing counter-export contract on the basis of the termination of the export contract only if that party was not responsible for the termination of the export contract. The countertrade agreement may further provide that when one of the parties is responsible for the termination of the export contract (e.g., because of delivery of defective goods, because of the failure to obtain administrative approval for the contract, or because of the failure to obtain the issuance of a letter of credit), the other party has an option either of maintaining in effect the countertrade commitment or the counter-export contract or of being released from its obligations thereunder.

55. [54] Paragraphs 48 to 54, above, addressed the question whether a termination of a supply contract in one direction is to affect the obligations of the parties to conclude or perform a supply contract in the other

direction. The parties may also wish to consider whether the termination of a supply contract in a given direction should obligate the parties to conclude a substitute supply contract in that same direction. An obligation to conclude a substitute supply contract may be considered appropriate in particular when the countertrade agreement provides for the conclusion of multiple supply contracts or when the countertrade agreement lists different types of countertrade goods.

3. Failure to pay

56. [55] In many countertrade transactions it is agreed that payment under the supply contract in one direction is to be made independently from payment under the supply contract in the other direction. For example, if under a counter-purchase or buy-back transaction the importer would delay its payments to the exporter, the exporter (counter-importer) would not be entitled to withhold payment under the counter-import contract or to set off its claim under the export contract against its payment obligation under the counter-import contract. Similarly, if the counter-importer would delay payment to the counter-exporter, the counter-exporter (importer) would not be entitled to withhold payment under the export contract or to set off the payment claims in the two directions. It is advisable that such agreement on independence of payment obligations be expressed in the countertrade agreement.

57. [56] It may be agreed, however, that, if a supplier has not been paid for goods delivered in one direction, that supplier is entitled to withhold payment for goods delivered in the other direction up to the amount of the outstanding claim or to set off the two countervailing claims.

58. [57] The advantage of independence of payment obligations is that the risk of non-payment under a supply contract in one direction is not increased by making the payment obligation under that contract dependent on the successful performance of a supply contract in the other direction. With such an approach, financing for a supply contract may be easier to obtain because the financing institution, in assessing the risk of non-payment, would not have to take into account circumstances extraneous to the supply contract to be financed (see also paragraph 43, above).

59. [58] The advantage of making the payment obligations interdependent is that of additional security to a party who does not receive payment for the goods it has supplied. If that party withholds payment or sets off the claims for payment under the supply contracts in the two directions, the result would be similar to a linked payment mechanism discussed in chapter IX, "Payment" (i.e., retention of funds, blocking of funds or setoff of countervailing claims for payment). The difference is that in the case discussed in this section the withholding of payment or setoff of claims is a fall-back right given to a party who does not receive payment, whereas under the linked payment mechanisms discussed in chapter IX, the linkage of payments is the anticipated method of payment.

60. [59] When it is agreed that a party is entitled to withhold payment or to set off the two countervailing payment obligations, it is sometimes also stipulated that the party who delivered goods first (exporter) is entitled to take possession of the goods that are to be delivered by the other party (importer). Taking possession of the goods would enable the exporter, who is

holding the outstanding claim, to obtain value and establish a payment obligation that could be set off against the outstanding claim. Such a stipulation is possible where the countertrade agreement specifies the goods that are to be counter-exported. In order to implement such an approach, it is advisable to identify clearly the goods and their location and to consider taking such additional measures as granting the exporter a security interest in those goods and giving the exporter an express right to claim their possession. A further measure may be for the countertrade parties to agree that the counter-exporter is to deposit the goods with a third person and to provide for the release of those goods to the counter-importer under specified conditions.

4. Failure to deliver goods

61. [60] The parties may wish to clarify in the countertrade agreement the consequences for the countertrade transaction of a failure to deliver, delayed delivery, or delivery of non-conforming goods under a supply contract in one direction. For delivery problems that result in the termination of a supply contract in one direction, the parties may wish to clarify in the countertrade agreement, as discussed in paragraphs 48 to 54, above, whether the termination is to affect the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. For delivery problems under a supply contract in one direction that do not result in termination of that supply contract, the parties may wish, for reasons explained in paragraphs 39 to 41, above, to provide expressly in the countertrade agreement that there should be no effect on the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. Such an independence of the obligations with respect to the shipments in the two directions may not be appropriate in buy-back transactions in which the counter-export of goods is contingent upon the proper implementation of the export contract.

Note

1/ Official Records of the United Nations Conference on Contracts for the International Sale of Goods (document A/CONF.97/18, annex 1); United Nations, Treaty Series, vol. __, No. __, p. ___; Yearbook of the United Nations Commission on International Trade Law, vol. XI:1980, part three, B.